

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Pipeline System LLC for Authorization to Guarantee Its Parent's Debt and Related Obligations, to Encumber Its Public Utility Property and to Treat the Cancellation of Its Outstanding Debt as Additional Member's Contribution, or Alternatively, Should Such Request Be Denied, to Incur Indebtedness Payable More than Twelve Months after the Date Incurred.

Application 03-07-052
(Filed July 31, 2003)

OPINION AUTHORIZING THE REFINANCING OF DEBT**I. Summary**

This decision authorizes Pacific Pipeline System LLC (PPS) to incur \$176.4 million of debt that matures on July 26, 2009. The debt authorized by today's decision may only be used to refinance \$176.4 million of debt that matured on August 8, 2003, and any short-term debt that PPS has issued since August 8 to refinance, on an interim basis, the debt that matured on August 8.

II. Background

PPS is a pipeline corporation as defined by Pub. Util. Code §§ 216(a), 227, and 228, and is subject to the Commission's jurisdiction pursuant to § 216(b).¹ PPS owns

¹ Unlike the situation with most other utilities, the Commission has not assigned a utility identification number to PPS (or to several other pipeline corporations). Hence, the caption for this proceeding does not contain a utility identification number pursuant to Rule 2.1(c).

and operates two common carrier crude oil pipeline systems. One system, known as Line 2000, consists of a 130-mile pipeline that extends from oil fields in Kern County to the Long Beach and El Segundo areas. The other system, known as Line 63, extends from Kern County to Carson in Los Angeles County. The Line 63 System also receives crude oil from the East Los Angeles and Wilmington fields.

In Decision (D.) 96-04-056, the Commission approved the construction and financing of Line 2000. In D.01-08-056, the Commission authorized PPS to refinance \$176.4 million of debt associated with the construction of Line 2000 and to extend the maturity of such debt to August 8, 2003.

PPS is owned by Pacific Energy Group LLC (PEG). On July 19, 2002, PEG entered into a credit agreement with Fleet National Bank and several other lenders (collectively "Fleet"). The Fleet Credit Agreement provides a \$225 million term loan facility to PEG that will mature in July 2009 and a \$200 million revolving credit facility that will mature in July 2007.² Contemporaneously with the closing of the Fleet term loan, PEG purchased PPS's outstanding note of \$176.4 million of Commission-approved debt and pledged the note to Fleet.

PEG's obligations under the Fleet Credit Agreement are guaranteed by all of PEG's operating subsidiaries except PPS and Pacific Terminals LLC (PT). Like PPS, PT is a pipeline corporation subject to the Commission's jurisdiction. The guaranty provided by the other subsidiaries is secured by the subsidiaries' assets, with one *de minimis* exception.³ PPS and PT did not provide such a

² The Fleet Credit Agreement is attached to Application (A.) 03-07-052 as Exhibit 4.

³ PPS states that the guaranty provided by Pacific Marketing and Transportation, LLC is not secured by its property because the value of the property did not warrant the cost that would have been incurred to provide the security interest.

guaranty or security arrangement because neither had prior Commission authority to do so.

III. The Application

In A.03-07-052, as supplemented,⁴ PPS requests Commission authority to refinance \$176.4 million of debt that PPS owes to its parent company, PEG. In particular, PPS requests Commission authority to guarantee PEG's obligations under the Fleet Credit Agreement to a maximum amount of \$176 million and to secure the guaranty with its operating assets. Once the Commission has approved the guaranty and associated security, PPS's debt would be cancelled and treated as additional equity.⁵

PPS offers several reasons why the Commission should authorize the guaranty and encumbrance. First, it would allow PPS to replace short-term debt with equity capital. Second, it provides PPS with an orderly means of replacing \$176.4 million of debt that matured on August 8, 2003. Finally, the debt that PPS would indirectly assume under the Fleet Credit Agreement has terms and conditions that are better than those that PPS could obtain on its own.

If the Commission does not authorize PPS to enter into the proposed guaranty and security arrangements, then PPS requests Commission authority to obtain a new \$176.4 million loan from PEG to replace the \$176.4 million loan that matured on August 8, 2003, and any short-term debt that PSS has issued to bridge the period between August 8 and the date the new loan is obtained

⁴ PPS filed two supplements to A.03-07-052 pursuant to instructions from the assigned Administrative Law Judge (ALJ). The first supplement was filed on August 29, 2003, and the second on September 30, 2003.

⁵ Like PPS, PT has filed an application with the Commission (A.03-07-051) to guarantee debt, to encumber public utility property, and to treat the cancellation of debt as additional equity, or alternatively, if such request is denied, to incur long-term debt.

pursuant to Commission authority.⁶ The terms and conditions of the new loan would be substantially the same as those in the revolving loan facility under the Fleet Credit Agreement, modified to reflect PPS's proportionate share of any interest rate hedge agreement entered into by PEG. The new loan would mature on July 26, 2009. The interest rate for the new loan would equal 7% on 75% of the principal amount, and the London Interbank Offering Rate (LIBOR)⁷ plus 275 basis points on 25% of the principal amount. The new loan would not be secured, but PEG would pledge its note from PPS to Fleet.

PPS asserts that it can easily pay the principal and interest on the new \$176.4 million loan. PPS's unaudited income statement for the year ended December 31, 2002, shows that PPS had \$71.5 million in revenues during 2002 and net income of \$24.2 million after operating and maintenance costs of \$26.9 million, depreciation expense of \$10.8 million, and interest expense of \$6.1 million. The \$6.1 million of interest expense included interest on PPS's outstanding, Commission-approved debt of \$176.4 million. Thus, PPS believes that its revenues are sufficient to cover day-to-day operations; ongoing maintenance, repair and capital investment requirements (the depreciation expense is sufficient to cover capital investment requirements); and interest expense. According to PPS, the net income of \$24.2 million in 2002 demonstrates that its operations provide sufficient funds for both debt repayment and dividends on equity capital.⁸

⁶ Under § 823(b), a utility may issue debt that matures in less than 12 months without Commission approval if such debt is used for proper purposes and does not violate any law.

⁷ There are different LIBOR rates (e.g., one-month rate, six-month rate, etc.). PPS may select any LIBOR rate between one and twelve months' duration.

⁸ PPS's income statement for 2002 and balance sheet for December 31, 2002, were contained in the supplement to A.03-07-052 submitted on August 29, 2003.

Notice of A.03-07-052 appeared in the Commission's Daily Calendar on August 6, 2003. There were no protests or other responses to the application.

IV. Discussion

The primary issues in this proceeding are whether PPS should be authorized to refinance \$176.4 million of outstanding debt and, if so, what means PPS should use to refinance the debt. The resolution of these issues is subject to Pub. Util. Code §§ 816, 817(d), 818, and 823(d) which state, in relevant part, as follows:

Section 816: The power of public utilities to issue [debt] is a special privilege, the right of supervision, regulation, restriction, and control of which is vested in the State, and such power shall be exercised as provided by law under such rules as the commission prescribes.

Section 817(d): A public utility may issue [debt] payable at periods of more than 12 months after the date thereof, for . . . the following purposes and no others . . . (d) For the discharge or lawful refunding of its obligations.

Section 818: No public utility may issue [debt] payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as otherwise permitted in the order . . . such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

Section 823(d): No note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by [debt] of any term or character . . . without the consent of the commission.

PPS's balance sheet shows that PPS does not have sufficient liquid assets to pay off \$176.4 million of debt.⁹ Accordingly, we find that PPS has a need to refinance \$176.4 million of debt that matured on August 8, 2003, and any short-term debt that PPS has issued to refinance the \$176.4 million on an interim basis pending the outcome of the instant proceeding. We also find that the large size of the refinancing (\$176.4 million) in relation to PPS's revenues (\$71.5 million) and net income (\$24.2 million) makes it impractical for PPS to charge the cost of the refinancing to operating expenses or income at this time.

PPS proposes two alternatives for refinancing \$176.4 million of debt that PPS owes to its parent company. PPS's preferred alternative is for the parent company to cancel the debt and for PPS to treat the cancellation as \$176.4 million in new equity. In return, PPS would guarantee \$176 million of debt already issued by the parent company and pledge its assets as collateral for the parent's debt. We presume that PPS would also be responsible, either directly or indirectly, for paying the principal and interest on the parent's debt.

Stripped to its essentials, PPS's preferred alternative for refinancing its debt amounts to off-balance-sheet financing. If we adopted this approach, PPS's balance sheet would present the rosy but deceptive picture of \$176.4 million in equity and little or no debt, even though PPS would be liable for \$176 million of its parent's debt and be *de facto* responsible for paying this debt. We conclude that the public interest is ill served by such Enron-esque financial arrangements,¹⁰ and we decline to adopt this approach.

⁹ PPS's balance sheet dated December 31, 2002, shows \$8.2 million of cash and total current assets, including cash, of \$34.2 million. (PPS Supplemental Exhibit 3.)

¹⁰ It has been widely reported in the financial press that the use of off-balance-sheet financing was one of the causes of Enron's financial collapse.

The second alternative is to refinance \$176.4 million of existing debt that PPS owes to its parent with \$176.4 million of new debt that PPS would owe to its parent. The terms and conditions of the new debt would be substantially the same as those in the Credit Agreement between the parent and Fleet, modified to reflect PPS's proportionate share of any interest rate hedge agreement entered into by the parent. The new debt would not be secured. PPS's income statement for 2002 indicates that PPS is capable of servicing the new debt. We find this approach to be straightforward and reasonable, and we will approve it pursuant to Pub. Util. Code §§ 816, 817(d), 818, and 823(d).

V. Exemption from the Competitive Bidding Rule

Pursuant to Resolution F-616, issued on October 1, 1986, utilities are required to issue debt using competitive bids. The purpose of this requirement, known as the Competitive Bidding Rule, is to reduce the cost of debt issued by utilities. Resolution F-616 also exempted several types of debt from the Competitive Bidding Rule. The exempted debt includes securities privately placed with specific lenders, bank term loans, and variable-interest debt. The debt authorized by today's decision falls within these exemptions.

VI. Pub. Util. Code § 1904(b)

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b), which states as follows:

For a certificate authorizing an issue of bonds, notes, or other evidences of indebtedness, two dollars (\$2) for each one thousand dollars (\$1,000) of the face value of the authorized issue or fraction thereof up to one million dollars (\$1,000,000), one dollar (\$1) for each one thousand dollars (\$1,000) over one million dollars (\$1,000,000) and up to ten million dollars (\$10,000,000), and fifty cents (\$0.50) for each

one thousand dollars (\$1,000) over ten million dollars (\$10,000,000), with a minimum fee in any case of fifty dollars (\$50). **No fee need be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge, or retire any stock, bond, note or other evidence of indebtedness on which a fee has theretofore been paid to the commission.** If the commission modified the amount of the issue requested in any case and the applicant thereupon elects not to avail itself of the commission's authorization, no fee shall be paid, and if such fee is paid prior to the issuance of such certificate by the commission, such fee shall be returned. (Emphasis added.)

The Commission previously authorized PPS to issue \$176.4 million of debt in D.01-08-056. In conjunction with that authorization, PPS paid a fee of \$94,200, the amount calculated pursuant to § 1904(b). Under the terms of § 1904(b), "No fee need be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge, or retire any stock, bond, note or other evidence of indebtedness on which a fee has theretofore been paid to the commission." In the present case, PPS is refinancing previously authorized debt on which it has already paid the requisite fee. Hence, PPS is not required to pay any additional fee pursuant to § 1904(b).

VII. General Order 24-B

General Order (GO) 24-B requires utilities to submit a monthly report to the Commission that contains, among other things, the following information: (1) the amount of debt issued by the utility during the previous month; (2) the total amount of debt outstanding at the end of the prior month; (3) the purposes for which the utility expended the proceeds realized from issuance of debt during the prior month; and (4) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and disbursements of money obtained from the issuance of debt. Although GO 24-B requires

monthly reporting, we routinely permit utilities to report quarterly to reduce the administrative cost of complying with the General Order.¹¹ We will likewise authorize PPS to submit on a quarterly basis the reports required by GO 24-B.

VIII. Categorization and Need for Hearings

In Resolution (Res.) ALJ 176-3117 dated August 21, 2003, the Commission preliminarily categorized A.03-07-052 as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3117.

IX. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is waived.

X. Assignment of Proceeding

The Assigned Commissioner for this proceeding is Susan P. Kennedy. The assigned ALJ is Timothy Kenney.

Findings of Fact

1. PPS is a public utility that operates common carrier crude oil pipeline systems that are subject to the Commission's jurisdiction under Pub. Util. Code §§ 216, 227, and 228.

2. In A.03-07-052, PPS requests, among other things, authority to enter into a new \$176.4 million loan with PEG to refinance (i) the \$176.4 million loan from PEG that matured on August 8, 2003, and (ii) any short-term bridge financing for the \$176.4 million loan that matured on August 8, 2003. The terms and

¹¹ See, e.g., D.01-02-011 and D.00-12-064.

conditions of the new loan would be substantially the same as those in the Credit Agreement between PEG and Fleet, modified to reflect PPS's proportionate share of any interest rate hedge agreement entered into by PEG. The new loan would mature on July 26, 2009, and would not be secured.

3. PPS has a need to refinance \$176.4 million of debt owed to its parent company PEG, that matured on August 8, 2003, and any short-term bridge financing for this debt.

Conclusions of Law

1. PPS should be authorized pursuant to Pub. Util. Code §§ 816, 817(d), 818, and 823(d) to obtain a new, unsecured loan in the amount of \$176.4 million from its parent company PEG, to refinance \$176.4 million of debt owed to PEG that matured on August 8, 2003, and any short-term bridge financing for the \$176.4 million of debt that matured on August 8, 2003.

2. The debt authorized by today's decision is exempt from the Competitive Bidding Rule set forth in Resolution F-616.

3. PPS is not required by Pub. Util. Code § 1904(b) to pay a fee on the debt refinancing authorized by today's decision.

4. The debt authorized by today's decision is subject to GO 24-B. PPS should be authorized to submit on a quarterly basis the information required by GO 24-B.

5. The following order should be effective immediately because PPS has an immediate need to refinance \$176.4 million of outstanding debt.

O R D E R

IT IS ORDERED that:

1. Pacific Pipeline System LLC (PPS) is authorized pursuant to Pub. Util. Code § 816 et seq., to issue \$176.4 million of unsecured debt, with a maturity date of July 26, 2009, and on terms and conditions that are substantively consistent with those set forth in Application (A.) 03-07-052.

2. PPS shall use the debt authorized by this order for the sole purpose of refinancing \$176.4 million of debt that matured on August 8, 2003, and any short-term debt that PPS has issued to refinance the \$176.4 million on an interim basis pending the outcome of the instant proceeding.

3. PPS may submit on a quarterly basis the information required by General Order 24-B.

4. A.03-07-052 is granted as set forth above.

5. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.